STATEMENT OF

LINCOLN NATIONAL **CORPORATION**

BEFORE THE

SUBCOMMITTEE ON FINANCE

AND HAZARDOUS MATERIALS

OF THE

COMMITTEE ON COMMERCE

ON

MODERNIZATION OF THE U.S. FINANCIAL **SYSTEM**

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Mister Chairman and members of the Subcommittee, my name is Mark Pope. I am Vice President and Director of Federal Government Relations for Lincoln National Corporation located in Fort Wayne, Indiana.

Lincoln National Corporation is a diversified financial services company with assets under management in excess of $70 billion. Lincoln is one of the country's leading providers of individual annuities, one of the world's largest life-health reinsurers and an exceptional provider of insurance for the small business market. We sell property & casualty insurance through our affiliate, American States Insurance, and we own a mutual fund company, Delaware Management Holdings.

I appreciate the opportunity to appear today to discuss Lincoln National's views on the way in which the financial services marketplace is evolving and how Congress can act to assure a sound, fair, and effective regulatory and competitive environment.

The Need for Legislation

At the outset, I want to compliment you for holding these hearings on how to rationalize the many aspects of the financial services regulatory structure that are in need of congressional attention. We believe that a comprehensive overhaul of the laws and regulations governing providers of financial services is long overdue and that there is much to be gained from this effort.

It appears that efforts to move this legislation have stalled recently. and that is indeed unfortunate. Never before have all the interested parties - banks, insurance companies, agent groups, and securities firms - indicated their willingness to work together to develop appropriate legislation. Whether the stagnation is due to missed deadlines for proposals or the press of other business, it seems to me that we risk losing a golden opportunity to develop meaningful legislation. Therefore, let me say again that Lincoln National Corporation sincerely appreciates your leadership and direction on this most important issue to our lines of business.

For too long important policy issues have been addressed by regulatory agencies or the courts rather than by Congress. This has not been an appropriate or effective process. As the marketplace has evolved over the years, policies underlying many of the laws governing providers of financial services have become outdated. Unfortunately, agencies continue to interpret these laws and the courts are forced to base their judgments on outdated policies. As a result, regulatory anomalies have multiplied, and the competitive balance among financial institutions has become artificially tilted.

In the same vein. the endless friction among insurers, banks and others has fostered uncenainty over the boundaries of state and federal laws as well as the appropriate limits of state and federal regulatory prerogatives. This uncertainty has made effective strategic planning far more difficult and has hindered companies in developing and marketing innovative products that would benefit business and consumers alike.

Importantly, deregulation by administrative fiat and policy formation by judicial process have time and again failed to assure that regulation - be it federal or state - achieves its two fundamental purposes, preservation of institutional safety and soundness for all types of institutions; and adequate protection for those purchasing products and services. The race to broaden powers by "interpretations" of existing law makes it much more difficult if not impossible to put in place essential institutional or consumer safeguards as the integration of financial services moves ahead.

These interpretations have typically been unilateral in nature and have benefitted only those institutions governed by the regulator rendering the interpretation. Beyond raising the issue of disparate and unfair competitive advantages, they deal by their nature only with the laws the single regulator administers. Thus, if a bank regulator expands the insurance powers of those it regulates by interpreting banking law, that regulator has no authority and little interest in addressing the competitive or consumer protection consequences that result on the insurance side of the equation.

A Broader Perspective

The above points illustrate that financial services restructuring must be handled by Congress, which looks at these issues from a much broader perspective than individual regulators or the courts. A concern of Lincoln National has been that proposals for ‘financial modernization” or "financial restructuring” have largely been efforts to deregulate banks. These proposals have been crafted largely by banks and their regulators and have focused almost exclusively on changes likely to be advantageous to depository institutions. Clearly, such a perspective is too narrow to fashion legislation that appropriately serves the needs of all sectors of the financial services industry. It is critical for Congress to consider the circumstances of all financial intermediaries and fashion legislation that strikes a reasonable regulatory and competitive balance for all concerned.

To some extent, the insurance industry has been to blame for this situation, Until recently, insurance groups have, for example, strongly opposed the concept of affiliations with commercial banks and declined to help “perfect” legislation to eliminate the barriers separating banking from other forms of commerce, including insurance. As noted immediately below and as detailed later in this statement, the industry has reversed its policy on affiliations and hopes that this action will facilitate the development of legislation that is fair across the board.

The insurance industry has already devoted considerable resources to a comprehensive evaluation of affiliations legislation and what provisions would be necessary to accommodate the needs and circumstances of its members. Our trade association, the American Council of Life Insurance, is working with a number of groups outside our industry, including banks and securities trade organizations, to integrate our legislative suggestions into proposals that up until now have contemplated only affiliations between banks and securities firms or have otherwise lacked direct input from insurers.

Insurance Industry Policy on Affiliations

until last year, the life insurance business had as a matter of policy opposed reciprocal ownership or affiliations between insurance companies and commercial banks. As business perspectives changed and as bank regulatory and court decisions continued to alter the practical and political dynamics of this debate, the industry gave increasing consideration to a change in policy. That process ultimately led to the industry's decision last September to support the concept of affiliations with banks provided that a number of fundamental principles were reflected in the enabling legislation. These principles, which are discussed later in this statement, are not intended to hinder banks' entry into our business or our entry into banking. Rather, they are intended to establish a fair and equitable statutory environment in which we can compete and in which our customers can enjoy the protections and assurances they have come to expect from traditional insurance carriers and those selling our products.

We believe our change in policy and similar actions by other insurance groups provide an unprecedented opportunity for Congress to act. Never before have most of the major segments of the financial services industry expressed their willingness to work cooperatively to help you fashion a workable means of modernizing the financial service-s industry.

Incentive for Legislation

We are concerned that some in the banking industry feel that business as usual is preferable to any legislation. Perhaps the biggest threat to financial services legislation is posed by those who believe that gaining even broader powers from regulators is achievable and that such a process is preferable to action by Congress because it prevents competitors from exercising reciprocal powers and may sidestep prudential constraints on behavior. We urge you to reject these efforts and move forward with legislation that is supported by a broad segment of the insurance, banking, and securities businesses as well as other providers of financial services. We hope this committee will be instrumental in helping to draft and enact such legislation.

Affiliations Not For Everyone

Congress must be mindful that not all insurance companies, securities firms, or banks may have tbe desire or the capability to affiliate. Product mixes, targeted markets, financial considerations, regulatory constraints, and a host of other factors will govern these decisions. The challenge will be to permit affiliations to occur without creating artificial disadvantages for those electing not to affiliate. It is for this reason that Lincoln National believes so strongly that the concept of regulation by function is the only realistic way to effectuate the integration of the various providers of financial services. Only in this way will there be assurance that the benefits and burdens of regulation fall equally on the stand-alone company and on the company in the same business that chooses to affiliate. Put differently, no insurance company should be put in the position of having to affiliate with a bank in order to compete effectively in its own core business. This is not to say that laws and regulations should interfere with the opportunity to realize potential synergies resulting from insurer/bank affiliations, cross-marketing, and similar arrangements. Clearly they should not. But law and regulation need not force firms to affiliate in order to be viable competitors in their own business. Lincoln National does not own a bank. I don’t know if we ever will, even if enabling legislation is passed. However, we believe that our current core businesses, including life insurance, annuities, mutual funds, pensions and reinsurance, can thrive in the financial world that exists after passage of financial modernization legislation, if and only if functional regulation remains the key point of that legislation.

Principles Important to Life Insurance Companies

Functional Regulation

As far as insurance companies are concerned, a critical element of any legislation to restructure the financial services industry is a requirement for functional regulation. Insurance activities, be they conducted by an unaffiliated insurance company, by a subsidiary or holding company affiliate of a bank, or (as may be the case with respect to insurance sales activities) directly in a bank must be subject to the same regulation by the appropriate State insurance authorities. Similarly, banking or securities activities, wherever conducted, must be regulated by the appropriate banking or securities regulatory authorities. For there to be genuine competitive equality in a restructured financial services marketplace, all those engaged in a particular activity must be subject to the same rules and regulations. Moreover, a regulator of one segment of the financial services industry must not be permitted to broaden unilaterally the powers of its industry members or take other administrative action which has the effect of circumventing the functional regulatory framework laid down by Congress.

This concept has not been popular with some in the banking industry who have continued to argue for institutional rather than functional regulation. There are several reasons put forward by banks to justify this approach, some which apply only to insurance sales and others of which have broader application. None, however. are persuasive to the insurance industry, which means that if legislation explicitly affords banks access to all insurance sales and underwriting powers, back door loopholes and preemptive actions by federal regulators must be eliminated. Whatever utility such strategies might have had in the past would be obviated by the express grant of insurance powers to banks and by appropriate limits on state action.

Several of the arguments against functional regulation that have surfaced over the last few months are discussed below.

1) States will enact statutes or institute rules governing the sales of insurance products that will discriminate against banks either overtly or in practical effect. Based largely on experience. drawn from disagreements with agent groups in various state legislatures over the past two decades, bankers feel they must be protected against dis crimination at the state level by retaining the Comptroller of the Currency's ("OCC") ability to preempt state laws inconsistent with powers otherwise authorized for national banks. Insurers believe that this protection can be afforded quite easily by prohibiting as a matter of federal law any express discrimination against banks. Exceptions to this general prohibition would be limited to certain disclosures relating to the absence of deposit insurance coverage for non-deposit products and other disclosures consistent with the uniform interagency guidelines to which banks are now subject. To give banks further comfort, states could be precluded from regulating the sales of insurance products in any way which had effect of putting banks in a less favorable position than other sellers of insurance.

2) States will enact statutes or institute rules governing the ownership or operation of insurance underwriters which discriminate against banks either overtly or in practical effect With the exception of banks, insurance companies have traditionally been permitted to affiliate, either as parents or subsidiaries, with virtually every type of corporate enterprise, including thrifts, non-bank banks,

and commercial companies. Historically, the states have never sought to distinguish the treatment of insurance underwriters based on corporate affiliation, nor is it apparent how such action could be justified. Further, as a result of insurance companies now embracing the concept of affiliations with banks and urging the preemption of state laws inconsistent with that concept, it should be clear that such attempted action by the states would be contrary to the economic self-interest of the insurance underwriting community and would be vigorously opposed. In any event, insurers believe there is no rationale for states to discriminate in the treatment of insurance undenvriters on the basis of corporate affiliation

3) It would be preferable to keep all regulation of national banks at the federal level. Some bankers have expressed the view that they are more comfortable with federal regulation and do not want to go to the trouble of having to deal with fifty state insurance departments. To them we suggest simply, if you wish to be in the business of selling insurance products, you should not object to playing by the same rules which govern all other sellers of insurance. Certainly. we would not suggest that if an insurer acquires a bank or a securities firm, those activities should be regulated by state insurance departments. Functional regulation remains the fairest way to harmonize the regulation of these disparate businesses.

Insurance Underwriting Must Be Kept Separate from the Bank

Closely related to the concept of functional regulation is the requirement that insurance underwriting activities, as distinguished from sales activities, be organized and capitalized in an entity separate from the bank, either as an affiliate or subsidiary. We believe this is necessary for several reasons. First, it is a means of insulating the banking component from the risks of insurance underwriting and vice versa. Second, it facilitates functional regulation, which would become more problematic if both insurance and banking regulators were attempting to regulate the solvency of a single entity. And third, it ensures competitive equality with respect to those insurers who, for whatever reason, choose not to affiliate with a bank.

This last point is particularly important because, as noted above, one of the principal conditions set forth by insurance companies for supporting the concept of affiliations is that they not be forced to affiliate with a bank in order to be an effective competitor in their own core insurance business. There is concern that if banks were permitted to conduct insurance underwriting activities directly within the bank under a different regulatory regime which did not impose the same reserve and capital requirements to which insurers are subject, the playing field would be tilted significantly and unjustifiably toward banks.

Beyond corporate separateness, it is essential to assess very carefully what "firewalls" are needed to protect institutional solvency and prevent less than arms-length dealing between a financial firm and its affiliates. All agree that legislation length dealing between a financial firm and its affiliates. All agree that legislation must accomplish the following: protect the integrity of both the federal deposit insurance funds and state insurance guaranty mechanisms; enable all regulators to assure the financial integrity of the institutions for which they are responsible; and ensure that as banks are given freedom to affiliate with insurance companies, securities firms, and others they do not enjoy unfair advantages in capitalizing their move into these other businesses due to deposit insurance or other elements of the federal safety net.

No Bank Regulatory Requirements, Including Solvency Stnndards, Should Materially Affect An Insurer's Operations

Mosr proposals for financial services restructuring are based on the bank holding company model which gives the Federal Reserve Board (the "Fed") broad authority to regulate holding company affiliates of banks and to require capital contributions from non-banking affiliates to bolster an insured institution that may become impaired under the so-called "source of strength doctrine". This may have been an acceptable regulatory model when bank holding companies were primarily involved in controlling banks and when banks were the only entities in the holding company system that were regulated for solvency. However, H.R. 268 and similar bills would radically alter the landscape. As a result, the traditional way of looking at bank holding company regulation is no longer valid. Indeed, imposing even a small degree of Fed regulation in the context of a life insurance company acting as financial service holding company would give rise to conflicts between federal and state regulatory objectives and causes tremendous concern for the life insurance industry.

Insurance company operations are extensively regulated at the state level for solvency. If an operating insurance company were also subject to regulation by the Fed, there is a strong potential for conflict between the Fed's principal objective of protecting the payments system. and insured depository institutions versus the state insurance regulatory objective of protecting policyholders and insurer solvency. Consequently, Fed requirements on financial regulation at the holding company level, including the "source of strength doctrine," are incompatible with a workable structure for combining banking and insurance.

We direct your attention to state insurance holding company statutes as a useful model for financial service holding company regulation. These statutes, which are in effect in all states, enable insurance regulators to monitor the activities of an insurer's affiliates while limiting solvency regulation to the insurer itself. This system has served the insurance industry well over the years in both good and bad economic climates. It is precisely this model which we urge Congress to consider in the context of affiliations. We believe it is appropriate to leave all substantive regulation at the institutional level and utilize holding company regulation as a means for regulators to gather necessary information on the activities of affiliates,

The issue of how new holding company structures should be regulated may be addressed in a variety of ways which may include loan prohibitions, added firewalls, increased reporting requirements, and possibly a new interagency regulatory committee, to name a few. Insurers are committed to resolving this issue in a way which results in competitive and regulatory equality for all financial service providers and their regulators. We look forward to working with the Subcommittee staff on the development of such an approach,

Commercial Affiliations

A great deal of attention has been focused on the question of whether it is desirable to remove the barrier separating banking and commerce. In the House, only the bill introduced last session by Representative Baker would permit a depository institution to be owned by a commercial entity. Other proposals, including H.B. 268, would permit a degree of commercial involvement but generally limit affiliations to those engaged in financial activities. We believe that drawing a distinction between finance and commerce is ill-conceived and that the real issue has already been decided- whether or not to allow depository institutions with federal deposit guarantees to affiliate with any other form of commerce, including finance. For all practical purposes, once that decision has been made in the affirmative, it is irrelevant whether the non-insurance component is an insurer an automaker or a long distance carrier. Whatever firewalls will be effective in protecting an insured depository institution from the market failure of its securities affiliate will work equally well for any other type of affiliation.

Insurers have a long history of owning, and being owned by, commercial entities without adverse consequences. We are convinced that adding an insured depository to the mix does not pose any additional difficulties that could not be addressed through a combination of firewalls and reporting requirements.

The unitary savings and loan holding company has worked successfully through the years and suggests there is no practical or regulatory difficulty in allowing broad affiliations between commercial entities and depository institutions.

If Congress is really concerned with concentration of economic power rather than with breaching some imaginary and artificial distinction between finance and commerce, we believe there are viable means of dealing with the issue short of prohibiting ownership by commercial firms.

Consumer Prorectlon Issues

The sale of insurance products by banks poses some, discrete consumer issues which need to be addressed. As noted previously, insurers strongly support state regulation of insurance and believe the states should have the authority to impose reasonable consumer protection measures, including regulations relating to bank sales of insurance products that are necessary to avoid consumer confusion or misunderstanding. However, we would oppose unwarranted limits on cross-marketing opportunities as well as constraints on banks' insurance sales activities which would unreasonably and unnecessarily put banks in a less favorable position than other sellers of insurance.

Preemption Of Other Inconsistent State Law

As noted above, one of the principal objectives of insurance industry policy relating to financial services restructuring is to preserve the state insurance regulatory system. It is also true, however, that in order for a restructured marketplace to operate effectively and fairly, the opportunity to affiliate and to realize the synergies of affiliations must not be dependent on one's state of domicile. For this reason, we believe that very limited preemption of state law is necessary, but only in the context of those state laws which would prohibit affiliations between financial service providers or would prohibit cross-marketing opportunities between affiliates.

Comments on Previously Introduced Legislative Proposals

H.R. 10 (Leach). This proposal from Chairman Leach generally tracks H.R, 1062 from the 104th Congress, although it now contains express language to permit banks to underwrite insurance through a holding company affiliate. With respect to functional regulation, the bill is largely unchanged. It attempts to set forth a mechanism for defining insurance, distinguishing sales from underwriting activities, limiting the authority of the OCC to contravene the role of state insurance regulation subject to the preemption standard set forth in the Barnett case, and requires the consideration of state views in determining whether new products should be classified as insurance or banking.

For the most part, the insurance-related language of H.R. 10 was drafted at a time when it was not clear that general affiliations between banks and insurers would be permitted in a fashion acceptable to the banking industry. As a result, there had to be compromises which provided banks more of a safety valve against anticipated restrictive actions of state insurance regulators with respect to both sales and underwriting. Even at the time it was negotiated, it was not warmly embraced by either industry. However, given the change in insurance industry policy, the express underwriting authority now contained in the proposal, and progress between bankers and insurers in other areas of negotiation, the bulk of the insurance language in H.R. 10 needs significant revision.

H.R. 10 is problematic for insurers for two other reasons described in more detail above: first, it does not lower the barriers between banking and commerce, thus foreclosing a significant segment of the insurance business with longstanding commercial affiliations from the restructured financial marketplace. Second, the bill retains the Federal Reserve Board as the principal regulator of any entity that owns a bank, thus setting up the clear potential for regulatory conflict for any state regulated insurer that acquires a downstream bank. Conflicting regulatory objectives between state and federal authorities, the use of the source of strength doctrine to pull capital front an insurer already subject to strict state solvency standards, and the potential for banks owning downstream insurers as operating subsidiaries to avoid these types of conflicts altogether all constitute significant negatives for insurers in the current draft of H.R. 10.

H.R 669 (Baker) This proposal is essentially a repeat of legislation which has been introduced in both Houses for the last three Congresses. More a philosophical statement than a detailed legislative proposal, it remains as the basic blueprint for broad restructuring of financial services markets, with the least holding company regulation and the least restriction on commercial affiliation.

The insurance industry has generally viewed H.R. 669 as the preferred model for financial services restructuring, recognizing that it was not politically realistic without substantial modification.

H.R. 268 (Roukema-Vento) Originally conceived as something of a middle ground between the earlier iteration of H.R. 10 and the D'Amato/Baker proposal, H.R. 268 has many of the most attractive elements of both bills. In addition, it has become a focal point for discussion by perhaps the broadest spectrum of financial service trade organizations ever to sit around the same negotiating table. For insurers, however, H.R. 268, like H.R. 10, has significant shortcomings. Although the Fed has a less intrusive role, the limitation on upstream commercial ownership remains.

The principal drawback, however is the absence of language addressing tbe issue of functional regulation. Clearly, this is no fault of the sponsors, who have patiently been awaiting the results of the continuing negotiations between the banking and insurance industries on this issue. While no final product has been agreed to, however, there are several principals that insurers feel must be embodied in whatever proposal ultimately moves forward:

* Banks should be expressly authorized to engage without limitation in insurance underwriting and sales.
* Insurers should be permitted to own, or affiliate with, banks.
* Section 92 of the National Bank Act should be repealed.
* The States should have the authority to define and regulate insurance, except that sales may not be regulated in any way that puts banks in a less favorable position than other sellers of insurance.
* The OCC should not be able to override state regulation of insurance.
* The Courts should give equal deference to state and federal regulators opinions with respect to disputes over the classification of new products as either banking or insurance.

It is my understanding that language has been drafted and is now being circulated among Congressional staff and interested industry representatives which adequately reflects each of these principles.

We believe these principals are fair to both industries and provide a reasonable means to resolve any regulatory disputes that may arise in the future. We want to emphasize that these points should be considered in the context of full affiliations between banking and insurance. Our overall objective remains to preserve the state insurance regulatory system while at the same time facilitating all the advantages that a restructured financial services market can bring to providers and consumers of these products. It is our hope that this Subcommittee and parent Commerce Committee can be an active participant in the development of a comprehensive restructuring proposal which is fair to all parties and can be enacted during this session of Congress. We look forward to working with this Committee in any way we can to achieve that goal.